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INDEPENDENT
TELEPHONE & TELECOMMUNICATIONS
ALLIANCE

August 21,2001

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Ms. Magalie Roman Salas, Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, DC 20554

Re: ITTA Comments for Developing a Unified Intercarrier Compensation Regime CC Docket No. 01-92

Dear Ms. Salas:

Please find enclosed an original **and** ten copies of the comments of the Independent Telephone & Telecommunications Alliance in the *Matter of Developing a Unified Intercarrier Compensation Regime,* Notice of Proposed Rulemaking in CC Docket No. 01-92. If you have any questions or comments, please do not hesitate to contact me directly at (202) 775-8116. Thank you for your consideration in this matter.

Sincerely,

David W. Zesiger
Executive Director

No. of Copies rec'd 0+10
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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Developing a Unified Intercarrier Compensation Regime	)	CC Docket No. 01-92
	)	

COMMENTS OF THE INDEPENDENT TELEPHONE & TELECOMMUNICATIONS ALLIANCE

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August 21, 2001

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In the past five years, the Commission has engaged in an unprecedented level of rulemaking. While adopted with the best of intentions and good faith, some of these rules have now begun to demonstrate the law of unintended consequences inherent in any regulatory undertaking. As a result, these rules have "distorted the economic incentives related to competitive entry into the local exchange and exchange access markets." In its Notice in this proceeding, the Commission appears to be willing to consider long term solutions to intercarrier compensation problems other than those relying upon even greater levels of regulation. ITTA supports new approaches which diminish the role of government regulation and minimize government intervention in the marketplace, the better to accentuate consumer demands and technological innovation in the future development of telecommunications products and services.

ITTA, which represents Midsize Companies in this proceeding, agrees with the Commission that current intercarrier compensation rules are a "patchwork" which leads to such undesirable results as regulatory arbitrage, artificial cost advantages, and incentives for inefficient entry. But ITTA believes that a fundamental problem lies with regulation, itself. Because government regulation cannot contend with rapid and widespread change in technology, markets, and consumer demands, it will necessarily produce distortions such as those set forth in the Notice. The key to fixing intercarrier compensation problems, then, is not to substitute a new set of complex regulations for an old set of complex regulations, but to focus on reducing the level of regulation, both as

the ultimate goal of the proceeding, and as a part of any transition process which changes in compensation regimes (if any) make necessary or desirable.

ITTA believes that several basic issues require consideration in evaluating future intercarrier compensation regimes. Changes in intercarrier compensation (particularly the proposed bill-and-keep approach) can have significant adverse effects on end users by increasing further the already large burden occasioned by e-rate, CALLS, non-rural universal service, and other proceedings. In addressing this issue, the Commission should again employ the standard that one size does not fit all. Proposed changes to regimes should be reviewed in the specific context of Midsize Company operations and markets, and any changes to existing compensation structures should allow for specific midsize differences. In making such determinations, the weight accorded economic theory should be balanced by the practical effects and outcomes impacting real consumers in real markets. Competition is an important consideration, but so are universal service and deregulation, as the 1996 Act makes clear.

ITTA proposes a number of areas for possible exploration and analysis in this proceeding, including an examination of cost definitions and methodologies; separations impacts; current implicit support in Midsize Company rates; alternative access charge structures; interim measures addressing transitional equities; the effects of Internet and IP telephony on intercarrier compensation issues; and possible traffic stimulation consequences of reduced or eliminated intercarrier compensation revenues under a bill-and-keep regime. ITTA believes that a thoughtful and comprehensive examination of these issues will most likely promote a conclusion to this rulemaking which will both enhance consumer welfare and reduce further unintended consequences from regulation.

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Developing a Unified Intercarrier	)	CC Docket No. 01-92
Compensation Regime	)	

COMMENTS OF THE
INDEPENDENT TELEPHONE & TELECOMMUNICATIONS ALLIANCE

A. Introduction

> This NPRM is motivated by numerous problems that have appeared recently concerning the existing rules governing intercarrier compensation. A primary concern is the opportunity, under the current regime, for profit-seeking behavior to take advantage of cost or revenue disparities that are solely due to regulation.[1]

Half a decade has passed since the adoption of the Telecommunications Act of 1996. In that time, the Commission has engaged in an unprecedented number of rulemakings, resulting in unprecedented increases in the number and scope of administrative rules being applied to the industry. To some degree, this activity has been justified by the Commission's need to interpret or to give meaning to a federal statute which the U.S. Supreme Court has described as "a model of ambiguity or indeed even self-contradiction."[2] In many cases, however, such increased regulation represented a conscious effort to directly order or influence market participation, activities, and structures according to economic theory. The Commission sought through such

[1] *In the Matter of Developing a Unified Intercarrier Compensation Regime,* Notice of Proposed Rulemaking, CC Docket No. *01-92* (released April *27,2001)* at ¶ 133 ("Intercarrier Compensation Notice"; also denoted "Notice" or "NPRM" in the text.).
[2] *AT&T Corp. v. Iowa Utilities Board et al., 1999* WL 24568 at *11 (U.S. 1999)("*Iowa Utilities I").*

intervention to redress perceived imbalances in position between various market participants by formulating rules of nationwide applicability:

> The inequality of bargaining power between incumbents and new entrants militates in favor of rules that have the effect of equalizing bargaining power in part because many new entrants seek to enter national or regional markets. National (as opposed to state) rules more directly address these competitive circumstances.[3]

The lawfulness of that intervention was largely sustained two years ago in *Iowa Utilities I.* But the consequences of that intervention are only now beginning to materialize. In several respects, those consequences entail adverse and unintended impacts on the public interest.

Notwithstanding the good faith and best efforts of the Commission, some of its rules have, inadvertently and unfortunately, "distorted the economic incentives related to competitive entry into the local exchange and exchange access markets."[4] Because the rules are national in scope, the distortion has been material in scope, in one cited instance alone resulting in revenue shifts measured in the billions of dollars.[5] These distortions create perverse incentives among competing carriers, causing them to forego congressionally intended competition in the marketplace in favor of gaming the increasingly complex system of regulations. The Commission has labeled the resulting problem one of "regulatory arbitrage," wherein:

> ...parties will revise or rearrange their transactions to exploit a more advantageous regulatory treatment, even though such actions, in the absence of regulation, would be viewed as costly or inefficient.[6]

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[3] *In the Matter of Implementation of the Local Competition Provisions of the Telecommunications Act of 1996,* First Report and Order, 11 FCC Rcd **15499 (1996)** at ¶ 55 *("First Local Competition Order").*
[4] *In the Matter of Intercarrier Compensation for ISP-Bound Traffic,* Order on Remand and Report and Order, FCC 01-**13**1 (rel. **April** 27,2001) at ¶ 2 ("*ISP Intercarrier Compensation Order").*
[5] *Id.* at ¶ 5.

Because of these distortions, regulation has become to a significant degree as much an objective of 'competitive' activity as the competitive markets the regulations were supposed to rapidly and effectively promote.

The Commission's NPRM is a timely recognition of these problems and of the fact that further increasing the number of regulations will not, concomitantly, increase the amount of competition in the marketplace. An approach of more of the same, in terms of increased regulatory intrusion into the marketplace, will neither remedy the current identified failings nor prevent new ones from emerging in the future.

This is an important turning of the regulatory tide. For the past five years, "better" has meant "more" in terms of regulatory intervention. The FCC's new intention here to test the concept of a unified compensation regime practicably will test as well the concept of relaxed regulation. The unification of reciprocal compensation and access under the proposed bill-and-keep framework, and the further intention to reduce the amounts collected under bill-and-keep to little or nothing, will effectively diminish or eliminate what is available to be actively federally regulated. While this idea has generated legitimate issues of concern, as Independent Telephone & Telecommunications Alliance (ITTA) discusses in subsequent sections of this pleading, the public interest long term is best served by reduced, not increased, regulation. The Commission's willingness to acknowledge the problem and work toward a solution is laudable, and ITTA supports this initiative.

ITTA acknowledges the timeliness of this initiative and welcomes the opportunity to offer its views on the issues raised by the Notice. In the past, ITTA has addressed the negative public interest effects of indiscriminate regulation. On numerous occasions, the

[6] *Intercarrier Compensation Notice* at ¶ 12.

Alliance and its members have worked positively to inject flexibility into federal regulation and regulatory processes.[7] ITTA continues to support reduced regulation, where practicable, and tailored regulation, where residually necessary.

In keeping with these views, ITTA believes the FCC will achieve its quest here for "a more permanent regime that consummates the pro-competitive vision of the Telecommunications Act of 1996"[8] only if and as the FCC also consummates the "de-regulatory" aspect of Congress' "national policy framework" likewise expressed in that Act.' The problem underlying this rulemaking is not so much a wrong regulation or wrong regulatory execution; it is regulation, itself -- particularly rules which, in the name of uniform theory, omit to recognize the non-uniform character of the entities to which they are applied. ITTA, as a participant over the course of these proceedings, will work with the FCC in an effort to identify the appropriate end goals constituting the "consummation" of the 1996 Act from the Midsize Company perspective. Equally important, ITTA will assist in developing the transitional devices necessary to ensure that the public served by its members is not exposed to adverse effects on service availability, diversity, and affordability as that transition is put into motion. To those ends, the Alliance offers these opening Comments in this proceeding.

B. ITTA agrees with the Commission on many matters identified in the Notice.

In ITTA's view, the NPRM rests upon a fundamentally sound cause-and-effect analysis of the current problems with intercarrier compensation. The effects flow from

[7] See, e.g., *In the Matter of Petitionfor Forbearance of the fndependent Telephone & Telecommunications Alliance,* Sixth Memorandum Opinion and Order, *1999* WL *439428, 14* FCC Rcd *10,840* (1999)*("ITTA Forbearance Petition").*
[8] *Intercarrier Compensation Notice* at ¶ 1.

the regulatory-induced but otherwise economically irrational actions engaged in by carriers, which detract from rather than contribute to consumer welfare. The Commission has identified multiple particular examples of such effects, including "regulatory arbitrage," "incentives for inefficient entry,"" rates "inefficiently set or structured," "artificial cost advantages," and rates which "significantly exceed" comparable and reasonable charges for a service." Such effects, as the Commission has stated, are "troubling" because they "prevent[] market forces from distributing limited investment resources to their utmost efficient uses."[12]

The cause of these effects, as the Commission also correctly notes, is the current "patchwork of intercarrier compensation rules"[13] applicable to reciprocal compensation and access charges. These rules were developed at various times in the past to address discreet issues in a historical context. Subsequent events, however, have conspired to materially alter the context in which the rules now apply, including events statutory, technological, and market-driven in nature. Regulations, like facilities, can become obsolete. The Commission itself has acknowledged this problem, for example, with respect to the Internet:

> The Commission has struggled with how to treat Internet traffic for regulatory purposes, given the bevy of its rules premised on the architecture and characteristics of the mature public switched telephone network.. ..The issue of intercarrier compensation for Internet-bound traffic with which we are presently wrestling is a manifestation of this growing challenge.[14]

> We believe it essential to re-evaluate these existing intercarrier compensation regimes in light of increasing competition and new

[9] Conference Report, Telecommunications Act of 1996 (January 31, 1996) at 1 ("S. 652 Conference Report").
[10] *ISP Intercarrier Compensation Order* at ¶ 21.
[11] *Intercarrier Compensation Notice* at ¶ 11-13.
[12] *ISP Intercarrier Compensation Order* at ¶ 4.
[13] *Id.* at ¶ 11.
[14] *ISP Intercarrier Compensation Order* at ¶ 19, 20.

> technologies, such as the Internet and Internet-based services, and commercial mobile radio services ("CMRS").[15]

As a result of changed circumstances, rules intended to effectively carry out Commission policy now effectively impede that policy.

ITTA also agrees with many of the general policy objectives which the Commission has articulated for these proceedings. The Commission has indicated, for example, that this proceeding is to be confined to the review and possible reform of existing intercarrier arrangements already subject to its rate-making regulatory powers. It does not seek "to extend compensation rules to other interconnection arrangements that are not currently subject to rate regulation and that do not exhibit market failure."[16] ITTA supports this limitation and the Commission's emerging theme of reliance on market forces in lieu of increased regulation:

> Consistent with the deregulatory goals of the 1996 Act, we seek an approach to intercarrier compensation that minimizes the need for regulatory intervention, both now and as competition continues to develop.[17]

ITTA has endorsed this approach in past filings with the Commission and has periodically identified specific rules and regulations no longer necessary to protect the public interest. ITTA is also currently working with Congress to reinforce this goal of reduced regulatory intervention in 1996 Act.[18] In both its legislative and regulatory participation, ITTA seeks to balance the need to protect consumer interests with the need to timely meet consumer demands. We therefore support the goal in this proceeding of reduced regulation.

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[15] *Intercarrier Compensation Notice* at ¶ 2.
[16] *Id.*
[17] *Id.*
[18] ITTA has actively supported the congressional legislation currently reflected in HR 496 and S 1359

The objective of reduced regulation is closely related to the objective of reducing regulatory-induced cost. In the NPRM. the Commission acknowledges that regulation and regulatory requirements are not cost-free:

> These alternatives [for billing termination] are not mutually exclusive, but they do involve transaction costs of measuring and billing; and notably, lower transaction costs are preferred to higher transaction costs. We invite comments on the relative sizes of transaction costs for these various alternatives, and how these transactions costs compare with other efficiencies (or lack thereof) for the various alternatives.[19]

Reducing the cost imposed directly or indirectly by regulation on carriers and consumers is a material goal in an economic environment of "limited investment resources," as noted by the Commission. Choosing policies which reduce regulatory intervention promotes reduction in costs associated with compliance. This course preserves funds for facilities and services rather than for processes and paper. The redirection of such funds enhances consumer welfare and promotes the public interest.

A course of avoiding unnecessary regulatory expense furthers, as well, the separate goal of "encourag[ing] efficient use of, and investment in, telecommunications networks.. .."[20] Infrastructure investment is a key element in the realization of consumer welfare. The goal of promoting facilities investment finds repeated expression in Congressional policy (for example, in Section 706[21]) and has been articulated by the Commission in other recent proceedings, such as that pertaining to universal service:

> Modern network infrastructure can provide access not only to voice services, but also data, graphics, video, and other services. …As we move forward in the future, we will consider ways to ensure that we do not create regulatory barriers to the deployment of advanced services. The principle thrust of the "no barriers"

[19] *Id.* at ¶ 51.
[20] *Id.* at ¶ 2.
[21] Telecommunications Act of 1996, Section 706 "Advanced Telecommunications Incentives" (not amending the Communications Act of 1934).

> proposal appears to be that the Commission should require carriers to deploy plant capable of providing access to advanced services, and encourage them to replace plant that cannot provide such access. Moreover, we believe any specific policies we adopt in this area should apply uniformly to all local exchange carriers.. ..[22]

Promoting investment in both basic and advanced telecommunications services is a necessary and desirable policy, which will be enhanced or impaired depending upon the choices made in this proceeding.

Finally, ITTA strongly endorses the measured approach to problem resolution underlying the NPRM. The inherent incapabilities of regulation, addressed in the next section of this pleading, apply whether the underlying intent is to expand or to diminish the active role of regulation in the market. Thus, consideration of "a different compliance timetable for small entities"[23] is warranted since a gradual approach to change protects the public interest by avoiding dislocations in rates for and availability of service. It is also appropriate and consistent with past Commission practice. As Chairman Powell noted in his separate statement:

> [T]he Commission has demonstrated its willingness to tackle complex and often intractable pricing-related issues while, when appropriate, giving carriers a transition period to adjust to new compensation regimes.[24]

Establishing a proper transition vehicle from present conditions to desired goals is, itself, an appropriate goal which ITTA will address in the course of this proceeding.

C. ITTA does not agree that the past approach of increased regulatory intervention will lead to positive results this time around.

This is not the first time the Commission has confronted a "patchwork" regulatory problem in intercarrier compensation:

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[22] *In **the** Matter of Federal-State Joint Board on Universal Service,* Fourteenth Report and Order, Twenty-Second Order on Reconsideration, and Further Notice of Proposed Rulemaking, CC Docket No. 00-256, 2001 WL 547795 at ¶ 200, 201.
[23] *Id.* at ¶ 128.

> The rules which we adopted in the Access Charge Order will replace with a single uniform mechanism the existing potpourri of mechanisms through which local carriers recover the cost of providing access services needed to complete interstate and foreign telecommunications.[25]

The current "patchwork" is no different in concept from the antecedent "potpourri" which it replaced. Now, as then, the Commission faces continuing and profound issues, rooted in prior factual determinations and policy decisions subsequently superseded by statutory, technological, and market changes.[26] In moving from "transitional intercarrier compensation regimes to a more permanent regime," the Commission will have two broad, alternative courses available to it: increased regulatory intervention, or decreased intervention. ITTA would urge the latter.

The NPRM bears witness to the fact that the FCC's historical path of increasing levels of regulatory intervention has proved increasingly ineffective and impracticable. As former Commissioner Furtchgott-Roth correctly notes, regulatory restrictions necessarily advantage someone and disadvantage someone else.[27] This condition produces distortions and gamesmanship, of which arbitrage in reciprocal compensation is a foreseeable consequence, rather than a unique, isolated anomaly

Current telecommunications regulations, developed for analog, voice oriented service provisioning, now confront digital, packet switched architectures and services. This is not a circumstance unique to this area of regulation: government regulation, generically, simply cannot contend with rapid and widespread change in technology, markets, or consumer desires. Regulation cannot predict consumers appetites with

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[24] *Intercarrier Compensation Notice, Separate Statement of Chairman Michael K. Powell,* at 1.
[25] *In the Matter of MTS and WATS Market Structure,* Memorandum Opinion and Order, 1983 WL 183026 (FCC 83-356) (1983) at ¶ 2("*MTS/WATS Order").*

sufficient accuracy – e.g., hula hoops, Beanie Babies, and bungee-jumping. The more micro-oriented and particularistic regulation becomes, the slower it becomes and the more interstices it creates – e.g., the Tax Code, which Treasury Secretary Paul H. O'Neill recently labeled "9,500 pages of gibberish."[28] The slower regulation becomes and the more interstices it creates, the more regulation detracts from market flexibility and the more it produces unintended, undesirable consequences – e.g., the ISP-Bound traffic arbitrage and terminating access abuses underlying the present proceeding.

These traits can be serious impediments to transforming a monopoly market to a competitive market. As one expert has noted:

> There is a very strong tendency for government agencies imbued with the traditional public utility regulatory philosophy to carry over into putatively competitive areas the same tendency to assume direct responsibility for the outcome, by micromanaging and handicapping the competitive process itself, in ways that threaten to jeopardize the very benefits that competition would otherwise bring to consumers.[29]

In contrast, the Commission here asserts in the NPRM its desire for "an approach to intercarrier compensation that minimizes the need for regulatory intervention, both now and as competition continues."[30] It further addresses regulatory intervention as a proper topic for party comment:

> It also seems appropriate to consider the degree of regulatory intervention required to implement various interconnection regimes. Some regimes require extensive regulatory intervention, while others are more market-oriented and thus largely self-administering. Market-oriented solutions may provide more timely adjustments and avoid distortions resulting from

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[26] See *Intercarrier Compensation Notice, Separate Statement of Commissioner Susan Ness:* "In an era of convergence of markets and technologies, this patchwork of regimes no longer makes sense. What had been a historical artifact may have become an unsustainable anomaly."
[27] *Id., Separate Statement of Commissioner Furchtgott-Roth* at *2*.
[28] Reported in *National Review,* Vol. LIII, No. 15 (August 6,2001) at 6.
[29] Kahn, Alfred E., "Deregulation: Micromanaging the Entry and Survival of Competitors," The Edison Electric Institute, Washington, D.C. (February, **1998)** at 7.
[30] *Intercarrier Compensation Notice* at ¶ *2*.

> incorrect or outdated regulatory decisions. They may also avoid substantial litigation costs.[31]

ITTA urges the Commission to adopt and to apply a market-oriented perspective to the reforms under review in this proceeding. Converting access and reciprocal compensation to bill-and-keep, and then reducing rates under bill-and-keep to little or nothing may seem a desirable, even enticing, regulatory cure for the current identified problems. But it won't be that simple or that permanent a fix, any more than substituting the access charges (now under critical review) for the prior "potpourri" was in 1983. To merely substitute new complex rules for old complex rules repeats past errors. To benefit the public, there should at least be some net diminution in the overall level of regulatory intervention reflected in the final outcome.[32]

Further, ITTA would urge the Commission to also consider reduced regulation as part of the process for achieving any final outcome, rather than only as a part of the final outcome itself. The FCC has begun to recognize in other proceedings the need for regulatory flexibility as a part of the trip, as well as a part of the destination. In the parallel ISP Intercarrier Compensation Order, for example, the FCC authorized a three-year transitional period for effecting changes in specified reciprocal compensation matters.[33] The RTF[34] and MAG[35] approaches reflect similar efforts to incorporate more flexibility into the process for achieving pro-consumer goals.

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[31] *Id.* at ¶ 34.
[32] See *Opening Statement of Michael K. Powell, Chairman, Federal Communications Commission, Subcommittee on Telecommunications and the Internet of the House Committee on Energy and Commerce* (March 29, 2001) at 2: "We will harness competition and market forces to drive efficient change and resist the temptation, as regulators, to m[o]ld markets in our image or the image of any particular industry player."
[33] *ISP Intercarrier Compensation Order* at ¶ **8.**
[34] See *In the Matter of Federal-State Joint Board on Universal Service,* Fourteenth Report and Order, Twenty-Second Order on Reconsideration, and Further Notice of Proposed Rulemaking, CC Docket No. 96-45, FCC 01-157 (rel. May 23,2001).

ITTA urges continuation of that approach in these proceedings. Sudden, significant changes in regulatory structures, particularly those impacting revenue flows between carriers, can do significant harm to carriers, investors, and consumers. The MAG proposal represents a reasonable approach to addressing the transitional equities inherent in any shift of regimes and typifies the ability to fashion mechanisms for addressing such matters in the course of moving to new structures (if such movement is, indeed, warranted).

In the past, Chairman Powell observed that deregulation was not a consequence of or reward for competition, to be withheld "until after competition has matured to some ill-defined level."[36] It was, rather, a goal to be pursued in its own right for the public interest benefits it will produce. ITTA has consistently supported this view and urges the Commission to affirmatively pursue reduced regulation as one of the goals of this proceeding.

D. ITTA has identified a number of basic considerations which need to be incorporated into the proposed rulemaking process.

The Commission has solicited the identification and discussion of issues raised or impacted by a bill-and-keep approach to intercarrier compensation. It has also requested similar discussion with respect to reform of the existing calling-party's-network-pays (CPNP) regime. In analyzing and discussing these alternatives, ITTA believes that this proceeding should, from the outset, incorporate the following principles for use in

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[35] See *In the Matter of Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers, and Interexchange Carriers,* Report and Order, CC Docket No. 00-256, FCC 01-157 (rel. May 23,2001).

[36] "Somewhere Over the Rainbow: The Need for Visions in the Deregulation of Communications Markets," *Remarks of Michael K. Powell, Commissioner, Federal Communications Commission, to the Federal Bar Association* (New York, May 27, 1998)(as prepared for delivery) at 3("Commissioner Powell FBA Speech").

assessing and adopting, to the extent warranted, any changes to the existing intercarrier compensation regimes or any transition to such regimes as proposed in the NPRM.

1. Changes in intercarrier compensation can adversely impact consumer services and prices.

Since the NPRM encompasses "a fundamental re-examination of all currently regulated forms of intercarrier compensation" it will likely have a much wider impact than mere reciprocal compensation or terminating access abuse. Particularly as to access charges, radical alterations in or the abolition of the current mechanisms and associated revenue flows between and among carriers will directly impact the scope, quality and – critically -- prices paid for service by Midsize Company consumers.

Consumers, who are at the bottom end of the regulatory chute, are the ones most likely to be adversely impacted by the reform of intercarrier Compensation regimes (and any slippage or errors arising from such reform). These consumers are already enduring a rising tide of rate increases, direct and indirect, occasioned by the growth in "e-rate" universal service programs for schools, libraries, and rural health care providers;[37] the transition to CALLS[38] (direct SLC increases and indirect increases for the new $650 million universal service fund); and other ongoing efforts to quantify and make explicit implicit subsidies currently imbedded in access charges. If the Commission intends to further increase this burden as a result of this proceeding, it should prepare a clear explanation and substantial justification for that course.

[37] See 47 U.S.C. §254(h)(1).
[38] See ***In the Matter of Access Charge Reform, Sixth*** Report ***and*** Order, CC Docket No. 96-262,2000 WL 1760912 (rel. May 31,2000).

2. Once *size* does not fit all.

Midsize Companies cannot be shoe-horned into solutions derived from or developed for larger local carriers. The Congress recognized the distinct character of Midsize Companies in several ways and places, including the 2% waiver (§251(f)(2)) and the report language accompanying the 1996 Act.[39] The FCC has recognized the distinction between the large ILECs and smaller ones in a number of prior proceedings,[40] and appears prepared to entertain such considerations here.[41] In recommending this consideration, ITTA recognizes the balance to be maintained between reflecting company differences in divergent compensation structures and permitting such divergent structures to be the source of arbitrage and other undesirable outcomes. As former Commissioner Ness observed:

> We must also resist applying legacy regimes to new services. Although it is not clear that a "one-size-fits-all" approach to intercarrier compensation is warranted, our goal must be a consistent and rational system that relies to the greatest extent possible on market forces –and not the possibility of arbitrage created by different payment structures –to drive technological advances and innovation.[42]

ITTA respectfully believes it is clear from past precedent that a one-size-fits-all approach is not warranted. Former Commissioner Ness' expressed concern for arbitrage is best addressed, not by mindless consistency in regulation, but by the reasoned diminution of regulation. As this very proceeding demonstrates, no regulatory system can be made

[39] S.652 Conference Report at 119.
[40] See, e.g., *ITTA Forbearance Petition* at ¶ *23:* "Accordingly, it is ordered, that the petition of the Independent Telephone & Telecommunications Alliance requesting that we forbear from applying to mid-size incumbent local exchange companies serving more than 50,000 access lines and less than two percent of the nation's access lines the requirement that they obtain a waiver or grant of a petition pursuant to section 69.4(g) of the Commission's rules before introducing a new exchange access service, is granted."
[41] *Intercarrier Compensation Notice* at ¶ 128.
[32] *Id., Separate Statement of Commissioner Susan Ness.*

manipulation-proof. Manipulation will decline as the means of such manipulation – regulation -- declines.

Recognizing Midsize Company differences in this proceeding will not contribute to arbitrage or other adverse effects, and will affirmatively prevent adverse impacts on the public interest. ITTA recites below its initial substantive positions which reflect the differences between Midsize Companies and others. Failure to recognize these differences will only lead to further regulatory miscarriage and further consumer harm.

3. Regulatory restructuring need not be an 'either/or' choice between separate regimes.

Although the NPRM appears to divide the world between bill-and-keep and calling-party's-network-pays ("CPNP"), a bifurcation of structures or of the paradigm ultimately adopted for intercarrier compensation may prove to be the best result for Midsize Companies. As with other Commission proceedings, some mechanisms may work in common for all carriers all of the time, but some may not. In the recent Rural Task Force Order, the Commission rejected an IXC demand "that the Commission follow the CALLS model for rural carriers."[43] Instead, the Commission recognized "that rural carriers face diverse circumstances and that 'one size does not fit all' in considering universal service support mechanisms that are appropriate...."[44] and acted congruently with that finding. As discussed above, the existence of different regimes need not, itself, result in arbitrage, where diminished regulation or regulatory flexibility are present to offset any such potential.

Moreover, historical examples of satisfactory dual regimes exist. The distinction between retail and wholesale customers and markets, for example, is both well developed

[43] *Rural Task Force Order* at ¶ 206 and n. 491.

and explicitly recognized in the 1996 Act. The concepts expressed in §251(c)(4) and §251(c)(3) do not represent inherently conflicting regimes but rather, as the FCC has repeatedly characterized them, compatible alternative vehicles for competitive entry into once-monopolistic markets.[45] The abandonment of such existing structures is necessarily a more drastic alternative than moderating their effects. The Commission's concurrent Orders in ISP-Bound and terminating access show that less drastic measures (including interim provisions) can be brought to bear, with less disruptive consequences than extirpative actions.

4. The practical impact of divergent cost definitions and economic theories needs to be considered.

The NPRM does not appear to direct much attention to problems latent in regulatory cost definition. Alternative cost theories, however, are currently at work in the intercarrier compensation arena, and may have material consequences in structuring proper intercarrier compensation regimes.

Presently, ILEC costs are defined differently for different purposes and in different jurisdictions. Forward looking economic costs (FLEC) are federally imposed for use by all ILECs for unbundled network element pricing under §251(c) and §252(d).[46] Such costs are also used by non-rural ILECs for universal service purposes, but are not so used at present (and for the next five years) by rural ILECs, which use instead modified

[44] *Id.* at ¶ 4.
[45] *In the Matter of Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, Third Report and Order and Fourth Notice of proposed Rulemaking, CC Docket No. 96-98 (released November 5, 1999) at ¶ 3: "Toward this end, section 251 imposes specific market-opening mechanisms, such as mandatory interconnection, unbundling, and resale requirements on incumbent LECs, in order to break the incumbent's control over local facilities."
[46] The definition, scope, applicability, and desirability of forward looking economic costs is under regulatory and judicial challenge in multiple agency and judicial proceedings, including those involving

embedded costs. Access charges for price cap ILECs are subject to FLEC analysis; those of rate-of-return ILECs to book costs. State commissions must apply FLEC cost definitions in §252 arbitrations of interconnection matters, but frequently must apply embedded or book cost definitions for state ratemaking purposes.[47] Where the same carriers occupy concurrent roles as customer-supplier and also as competitors in the same markets, divergent cost recognition schemes may be a source of intercarrier abuse (e.g., arbitrage), jurisdictional wrangling (e.g., earnings adequacy), or consumer complaint (e.g., local rate or SLC increases). The effects of these may be ameliorated or worsened by changes in the compensation regimes under review here.

Like cost definition, cost causation theory may also prove a source of difficulty. Asking cost causation questions -- who 'causes' a cost and who 'benefits' from the cost – may well have utility in discussing economic theory, but may also lead to a narrowed focus of increasing disutility to more practical considerations. In establishing the current access charge regime back in 1983, the Commission arguably was less concerned with who "caused" the cost and more concerned with addressing such policy issues as the elimination of unreasonable discrimination and undue preferences, efficient use of the network, avoidance of uneconomic bypass, and the preservation of universal service.[48] From this perspective, the COBAK and BASICS proposals are simply more of the same – well-reasoned economic theories, but one is as unavoidably flawed as another without reference to actual market events. As ISP-bound arbitrage demonstrates, without reality

some of ITTA's members. The recitation here is not meant to condone or to concur in any specific Commission ruling concerning the application of FLEC in any particular circumstance or proceeding.

[41] See, e.g., A.S. 42.05.441(b)(Alaska): "In determining the value for rate-making purposes of public utility property used and useful in rendering service to the public, the commission shall be guided by acquisition cost or, if lower, the original cost of the property to the person first devoting it to public service, less accrued depreciation, plus materials and supplies and a reasonable allowance for cash working capital when required."

checks, such theorizing can lead to interesting but artificial parsing – i.e., whether an end user pays all of one set of costs (COBAK) or half of two sets of costs **(BASICS)** does not change the fact that end users ultimately could be paying the full ticket. Whether this is a good or bad policy result depends on factual considerations such as network costs, population densities, geographic and climatic considerations, etc., and the resulting effects on affordability and availability for individual consumers -- an outcome not predicted by these theories.

Other economic theories are also implicated in intercarrier compensation issues. For example, the U.S Supreme Court has frequently discussed the right of owners of private property devoted to public use to a reasonable opportunity for a reasonable return on investment.[49] To the extent Midsize Companies are required in the future to act in response to regulatory direction, that direction must admit of earnings opportunities, a consideration which could influence the choice of intercarrier compensation regimes.[50] Placing the burden for all cost recovery solely upon end users, for example, could lead to unaffordable rates and thus undermine any reasonable opportunity for reasonable earnings on the jurisdictional investment.

Finally, market activity unencumbered by regulatory-imposed econometric overlays is itself a legitimate consideration in reviewing current intercarrier compensation regimes. The NPRM acknowledges the need to limit regulatory expansion at the outset of

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[48] *MTS/WATS Order* at ¶ 2. Compare to *Intercarrier Compensation Order* n. 36.
[49] See, e.g., *Bluefield Water Works & Improvement Company v. P.S.C. of West Virginia,* 262 U.S. 679 (1923); *FPC* v. *Hope Natural Gas,* 320 U.S. 591 (1944); *Duquesne Light co. v. Barasch,* 488 U.S. 299 (1989).
[50] ITTA believes that the recent U.S. Circuit Court opinions in *Iowa Utilities Board v. Federal Communications Commission,* 219 F.3d 744 (8th Cir., 2000) and *Texas Office of Public Utility Counsel et al.* v. *Federal Communications Commission,* 183 F.3d 393 (5th Cir., 1999) do not squarely address and are not dispositive of these issues.

the Notice." But the NPRM does not seem to consistently recognize a long-term strategic perspective directed toward reducing or eliminating, in measured fashion, intrusive regulatory regimes of all kinds, in favor of market-driven, market-oriented conduct by market participants. The NPRM, which focuses on substituting regulations, contrasts with former Commissioner Furtchgott-Roth's comments which focus on reducing regulation:

> Requiring intercarrier compensation of specific forms, such as bill-and-keep, is nothing more than price regulation – harmful to contracts, carriers, consumers, and the public at large.[52]

ITTA recognizes the need for moderation and transitional planning in dismantling prior regulatory regimes. But such needs should not obscure the ultimate goals of market flexibility and market responsiveness which ITTA's members have sought and continue to seek through both regulatory and legislative means.

5. Deregulation and universal service – along with competition -- require recognition in developing new regulatory regimes.

Competition is unquestionably the preferred vehicle for improving consumer welfare. But competition works fairly and effectively only if other things also work, in balance. The existence of arbitrage and the other abuses identified by the Commission in the NPRM and related proceedings reflect that other matters are not yet in balance, and therefore require additional consideration in this proceeding.

ITTA has discussed above the public interest benefits to be derived from reduced regulation. Among other considerations, reduced regulation increases exposure to competition, forcing companies to choose between the past and the future – "to decide if they want to remain cozy in the confines of regulatory protectionism or take the field as

[51] *Intercarrier Compensation Notice* at ¶ *2* and n.2.
[52] *Id.*, *Separate Statement of Commissioner Harold Furchtgott-Roth* at *2*.

competitors and innovators."[53] ITTA's members have already taken significant strides towards innovation and competitive action in the marketplace. Indeed, one of its members, Alaska Communications Systems, operates as the incumbent LEC in what is presently the most competitive local market in the country.[54] The concern of ITTA's members, reasonably, is that the NPRM will not balance the focus on theory-driven regulatory reforms with an equal focus on empirically-driven reforms responsive to existing and emerging conditions in the marketplace.

Universal service, likewise, deserves equal time and attention. Availability and affordability, the key components of a sustained universal service program, may be adversely impacted by redistribution of the cost burdens implied in the NPRM. If the FCC intends to take bill-and-keep to "0," it must (as NARUC has suggested[55]) consider carefully the impacts on end users -- their ability to maintain access to the network and the quality of the network they are accessing. This is especially true in the context of concurrent §706 and RTF initiatives, discussed above, which portend access to advanced/enhanced services as part of basic universal service.

E. ITTA has identified a number of specific Midsize Company issues to be addressed in this proceeding.

Midsize Companies represent a distinct segment of the telecommunications industry, encompassing price cap and non-price cap, rural and non-rural carriers. In the course of

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[53] *Commissioner Powell FBA **Speech*** at ***3***.

[54] G. Nanette Thompson, Chair, Regulatory Commission of Alaska, quoted in *Alaska Journal of Commerce,* "Phone Competition Fast, Fierce in City" (August 12,2001) at 5:"Since then the changes have been dramatic in the Anchorage market. The competing phone company has a bigger share of the local service market in Anchorage than in any other urban market nationally. My colleagues on other state commissions are astonished to hear that a competitor has captured 35 to 45 percent of the Anchorage market."

these proceedings, ITTA will focus on issues with particular import for the future operations of these companies, and particularly on the effects of regulatory alternatives on the scope, range, availability, and cost of services to Midsize Company-served consumers. Among the matters warranting attention, ITTA notes the following list for further development in this rulemaking.

1. **Cost definitions and methodologies:** Identification and application of forward looking economic cost, modified embedded cost and book cost methodologies; analysis of comparative impacts of choice of methodology on rates, availability and affordability of service; analysis of effects on infrastructure investment and capital recovery.
2. **Separations impacts:** Identification of separations issues and impacts raised by NPRM alternatives; analysis of current legal and regulatory requirements attending separations establishment and adjustments; characteristics of 2% company systems and markets, such as nature of infrastructure, network usage, scope and scale issues, etc., influencing jurisdictional separations of expense and investment; assessment of resulting effects on rates and services, and capital recovery.
3. **Implicit support:** Measuring amount of 'implicit' support in current Midsize Company access charge structures; characteristics of 2% company markets, customer bases, and networks influencing implicit support determinations; analysis of past regulatory implicit support policies on 2% companies;.

[55] See http://www.naruc.org/Resolutions/2001summer (accessed August 12, 2001), *"Resolution Regarding the Development of a Unified 'Bill-and-Keep' Intercarrier Compensation Regime"* and *"Resolution on Jurisdictional Issues for Internet-Bound Traffic"* (adopted July 18, 2001)

4. **Alternative access structures:** Identifying specific mechanisms (existing, proposed, or a mix) which would address Midsize Company needs most efficiently and consistently with consumer interests, including Rural Task Force and MAG Plan outcomes.
5. **Interim and transitional requirements:** Assessment of mechanisms for recognizing transitional equities in achieving long-term goals, including pricing, market, and management flexibility, infrastructure investment incentives, explicit support requirements, and forbearance requirements.
6. **Internet/IP telephony:** Analysis of bypass potential and impacts; assessment of regulatory parity requirements, market flexibility needs, and interim transitional measures.
7. **Interexchange traffic stimulation:** Projection of traffic stimulation effects from reduced access charges (including flow-through assumptions); assessment of derivative effects on facilities use, cost allocations, jurisdictional separations, and historical rate design; analysis of impacts on end user rates of alternative compensation regimes.

F. Conclusion

The Commission has undertaken a necessary, long overdue step toward restoring balance in and to the implementation of the 1996 Act. The pro-regulatory path followed in the past five years has, perhaps, promoted some elements of competitive activity, but has definitely produced distortions disserving the public interest. In seeking "an approach to intercarrier compensation which minimizes the need for regulatory intervention, both

now and *3s* competition continues to develop,"[56] the Commissioning is establishing a new and firm foundation for achieving both the "pro-competitive" and the "deregulatory" vision expressed by Congress half a decade ago.

ITTA and its members have made significant contributions to FCC initiatives in the past, particularly with respect to modifying regulatory regimes to fit Midsize Company market and consumer needs. The Alliance has maintained an active presence with Congressional members and staff and will seek to synchronize congressional and agency goals and means over the course of this proceeding. We look forward to working with the FCC and other affected parties to find intercarrier compensation solutions which will address the pro-competitive, deregulatory, and universal service goals of the 1996 Act in a balanced and comprehensive way.

Respectfully submitted,

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[56] Intercarrier Compensation Notice at ¶ 2.